

**STATE BOARD OF EQUALIZATION**

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June 12, 2002

JAMES E. SPEED
Executive Director

Ms. C--- R---
Accounting
F--- C--- Solutions
XXXX --- Boulevard
--- ---, California XXXXX

Re: Request for Legal Opinion

Dear Ms. R---:

By letter dated June 5, 2002, we responded to your inquiry of February 4, 2002, regarding F---'s contract with the B--- P--- Tribe. After sending you our response, we reviewed the matter further and concluded that portions of our June 5 letter concerning F---'s subcontractors needed additional clarification. Therefore, we have amended our letter to include these clarifications, denoting these clarifications by underlining the added text and placing vertical lines in the margin of this letter. Accordingly, today's letter, with its clarifications, supercedes *and replaces* our previous response of June 5, 2002. We emphasize, as we did in our original response, that as to F---'s subcontractors this letter provides only general comments, and that the subcontractors cannot rely on this advice pursuant to Revenue and Taxation Code section 6596 and Regulation 1705.

This is in response to your February 4, 2002 letter addressed to Assistant Chief Counsel Janice L. Thurston of the State Board of Equalization's Legal Division. We apologize for the delay in our response.

In your letter, you state:

"F---, Inc. is a general contractor/construction manager/design builder, headquartered in ---, Oklahoma with an office in --- ---, California. We are planning to build a 30,000 sf office building for the B--- P--- Tribe in B---, California. The owner of this project is B--- P--- Development Corporation, a federally recognized Indian Tribe. This will be a Cost Plus A Fee Contract. The purpose of this letter is to request proper application of tax and the consequences of certain contractual language as stated below.

‘Cost of the work plus five percent (5%) not to exceed --- Million, --- --- Thousand Dollars (\$X,XXX,000). It is the intent of the parties that the Design/Builder and the Design/Builder’s Subcontractors be “sellers of materials” as provided in 18 California Administrative Code 1521. The Design/Builder hereby states that the total sales price of materials to be used in this project is --- Million, --- Hundred --- Thousand, --- Hundred --- Dollars (\$X,XXX,XXX.). This price is exclusive of the charge for installation. Title to all materials to be used in this project shall transfer to the Owner at the time of delivery to the reservation and prior to the time the materials are installed by the Design/Builder or any of the Design/Builder’s subcontractors.’

“Is the above language in F---’s contract and in F---’s subcontracts sufficient to qualify F--- and F---’s subcontractors as retailers of the materials to the B--- P--- Development Corporation pursuant to Sales and Use Tax Regulation 1521 (b) (2) (A) 2? Accordingly, since sales to the tribe on the reservation are exempt from tax would sales tax be due?”

Additionally, during our telephone conversation of April 9, 2002, you clarified that F---’s subcontractors will purchase materials from their vendors for resale, resell the materials to F--- prior to installation or other use and receive payment from F---. In turn, F--- will sell the materials to the Tribe prior to installation or other use.

We note that if the contract language you quote were included in the subcontractors’ contracts, title to the materials would pass from the subcontractors directly to the Tribe, rather than first to F---, and from F--- to the Tribe. We therefore assume that the language in the subcontracts is not identical to the contract language you quote, above, but instead includes the necessary modifications appropriate to contracts between F--- and its subcontractors. We further assume that the subcontractors’ contracts with F--- (1) explicitly provide for transfer of title to the materials to F--- prior to the time materials are installed, and (2) separately state the sale price of the materials exclusive of the charge for installation. We also assume that F--- will provide its subcontractors timely and valid resale certificates for its purchases of materials from its subcontractors.

We further note that the phrase “delivery to the reservation” used in your quoted language should be clarified to state that both parties to the contract understand and agree that the delivery referred to is the actual physical delivery of the materials to the purchaser on the reservation. The phrase as currently written could be regarded as ambiguous on this point. As discussed in substantial detail later in this letter, the place of delivery of the materials affects the taxability of the sale to the Tribe.

If F---’s actual situation differs from the facts as assumed and stated herein, our advice would be different. Before responding to your specific questions, we further note that this opinion applies only to F---, Inc. (“F---”). Therefore, only F--- may rely on this opinion under the provisions of Revenue and Taxation Code section 6596 and Regulation 1705 (copy enclosed). We also note that you do not identify F---’s subcontractors. Therefore, our comments concerning transactions by F---’s

subcontractors are only general comments and not written advice upon which F---'s subcontractors may rely pursuant to either Revenue and Taxation Code section 6596 or Regulation 1705.

In addition, we understand your letter to mean that the "owner" is the B--- P--- Development Corporation which is organized under Tribal authority and wholly owned by a federally recognized Indian Tribe. We assume that F--- is not a Tribal entity. Your letter specifically inquires only about materials, and not fixtures or machinery and equipment or other tangible personal property, and we have, accordingly, limited our response to a discussion of materials.

Discussion:

As a starting point, sales tax is imposed on a retailer's retail sale of tangible personal property in this state, measured by a percentage of gross receipts, unless the sale is specifically exempted or excluded by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax applies to the storage, use or other consumption of tangible personal property purchased from any retailer for storage, use or other consumption in this state, measured by a percentage of the sales price, unless that use is specifically exempted or excluded by statute. (Rev. & Tax. Code §§ 6201, 6401.) "Gross receipts" or "sales price" generally include all amounts received with respect to the sale of tangible personal property, with no deduction for the cost of materials used, labor or service costs, or other expenses of the retailer, unless there is a specific statutory exclusion or exemption. (Rev. & Tax. Code §§ 6011, 6012.)

Specific provisions of the Sales and Use Tax Law apply to sales made on and off Indian reservations to Indians. These provisions are explained in Regulation 1616.¹ When a non-Indian retailer negotiates and makes a sale of tangible personal property at an on-reservation place of business to a non-Indian customer (including a sale to an Indian who does not reside on a reservation) sales or use tax applies if the sale is otherwise subject to tax. (See Reg. 1616(d)(3)(B)2.) When a non-Indian retailer negotiates and makes a sale of tangible personal property at an on-reservation place of business, to an Indian customer who resides on a reservation, sales tax does not apply if the property is delivered to the Indian purchaser on a reservation. (Reg. 1616(d)(3)(B)1.) When a non-Indian retailer negotiates and makes a sale of tangible personal property to an Indian, at a place of business off a reservation, that sale is not subject to tax if the delivery is made to the Indian purchaser on a reservation and title (ownership) transfers to the purchaser on a reservation. (Reg. 1616(d)(4)(A).)

Regulation 1616(d) also sets forth the application of tax to construction contracts for permanent improvements to real property on the reservation. However, before discussing how Regulation 1616 applies to such contracts we will explain the application of the Sales and Use Tax Law to construction contracts in general.

In general, a construction contractor furnishing and installing materials is the consumer of materials, and tax applies to the vendor's sale of materials to the construction contractor (Reg. 1521(b)(2)(A)1.), not to the transaction between the construction contractor and its customer. However,

¹ Please note that the Board approved amendments to Regulation 1616 on March 27, 2002, and the regulation as amended has been submitted to the Office of Administrative Law for its review. A copy of the Board-approved amendments (underlined portions) to Regulation 1616 is enclosed for your reference.

a construction contractor may be deemed the retailer of materials, rather than the consumer of materials, upon compliance with the following provisions of Regulation 1521(b)(2)(A)2.:

“2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge for installation, the contractor will be deemed to be the retailer of the materials.”

Regulation 1616(d)(4)(C) explains the application of sales tax to construction contractors on Indian reservations. Sales tax does not apply to sales of materials to Indian contractors (i.e., contractors who are Indians) if the property is delivered to the Indian contractor on the reservation. (Reg. 1616(d)(4)(C)1.) On the other hand, Reg. 1616(d)(4)(C)2. explains that sales tax does apply to sales of materials to non-Indian contractors (i.e., contractors who are not Indians) notwithstanding the delivery of the materials on the reservation and the permanent attachment of those materials to the realty.

Regulation 1616(d)(4)(C)2. can be interpreted as subjecting to tax all sales of materials to non-Indian contractors, irrespective of the provisions of Regulation 1521(b)(2)(A)1. (Cf. Reg. 1521(b)(1)(A) re sales of fixtures and materials to U.S. construction contractors.) While the matter is not entirely free from doubt, we instead read the provisions of Regulation 1616(d)(4)(C)1. together with the provisions of Regulation 1521(b)(2)(A)1. and 2. to reach the conclusions that (1) this provision of Regulation 1616(d) refers to those transactions in which the construction contractor is a consumer who furnishes and installs materials and not to those transactions in which the construction contractor would otherwise be deemed a retailer of materials; and (2) this provision of Regulation 1616(d) does not prohibit the construction contractor from being the retailer of materials if the construction contractor complies with Regulation 1521(b)(2)(A)2.²

When the construction contractor complies with the provisions of Regulation 1521(b)(2)(A)2. and thereby is deemed a retailer, the construction contractor may purchase the materials from its vendor for resale, and timely provide its vendor with a resale certificate as provided in Regulation 1668. The construction contractor may resell the materials as a retail sale prior to making any use of them (e.g., installing them) only by complying with the provisions of Regulation 1521(b)(2)(A)2.; that is, only if (1) its construction contract separately states the sales price of materials, exclusive of the charge for installation (e.g., a time and material contract as described in Regulation 1521(a)(7)), (2) the contract

² This differs from the treatment of construction contractors who contract with the United States government. U.S. construction contractors are always consumers and never retailers of materials and fixtures which they furnish and install for the U.S. government. Tax always applies to the sale of fixtures and materials to the construction contractor or the construction contractor's use of the materials, even if the contractor were to purport to purchase the property as the agent of the United States or purport to sell the materials or fixtures to the U.S. prior to installing them. U.S. construction contractors are generally not the retailers of fixtures or materials (*In re Howell* (9th Cir. 1984) 731 F.2d 624) and, as such, cannot pass title of these items to the U.S. government prior to use and thereby avoid tax. (If the U.S. construction contractor provides a resale certificate to its vendor, the construction contractor is liable for use tax (BTLG Annot. 190.2580 (7/24/91).) Such tax avoidance is possible only with a U.S. construction contractor's sale of supplies, machinery or equipment where title to the property passes to the United States prior to the contractor's making any use of it. (Rev. & Tax. Code §§ 6007.5, 6384; Reg. 1521(b)(1)(B); *Aerospace Corp. v. State Bd. of Equalization* (1990) 218 Cal.App.3d 1300.)

explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and (3) in fact, the contractual provisions are carried out.³ The fact that the Indian Tribe may have paid the contractor will not exempt the transaction from tax if the above requirements are not met.

A construction subcontractor generally cannot avoid liability for tax on its use of materials furnished and installed by him or her by taking a resale certificate from the prime contractor. (Reg. 1521(b)(6)(A).) However, a construction subcontractor that sells materials to the general contractor under subdivision (b)(2)(A)2. of Regulation 1521 may accept a resale certificate from the prime contractor only if the prime contractor will, in turn, sell the materials under subdivision (b)(2)(A)2. of Regulation 1521, and the prime contractor's sale of the materials is an exempt sale to an Indian, i.e., a sale fulfilling the requirements of Regulation 1616(d)(4)(A).

Even if the construction contract were to comply with the provisions of Regulation 1521(b)(2)(A)2., the construction contractor, as retailer, must in fact pass title to the materials to the Indian Tribe on the reservation, and must do so prior to use in order for the retail sale of the materials to be exempt from tax.⁴ When this occurs, the contractor selling materials to the Indian Tribe should obtain an exemption certificate as described in Regulation 1667 from the Indian Tribe to substantiate that its sale was exempt from California sales or use tax. The contractor must also make available a copy of this exemption certificate to any vendor that is also a subcontractor, when that subcontractor/vendor accepts a resale certificate from the contractor.

We next respond to your specific inquiries.

Regarding that contract language quoted, *supra*, you ask:

“Is the above language in F---’s contract and in F---’s subcontracts sufficient to qualify F--- and F---’s subcontractors as retailers of the materials to the B--- P--- Development Corporation pursuant to Sales and Use Tax Regulation 1521 (b) (2) (A) 2? Accordingly, since sales to the tribe on the reservation are exempt from tax would sales tax be due?”

As we have previously noted, based upon our telephone conversation of April 9, 2002, we understand and assume that F--- contemplates that its subcontractors will purchase materials from vendors, the subcontractors will resell the materials to F--- and receive payment from F---, and that F--- will in turn sell the materials to the Tribe and be paid by the Tribe. We also understand and assume that either F--- or the subcontractors will, thereafter, install the materials in the construction project on the reservation.

³ If a subcontractor in fact passes title, not to the Indian Tribe, but to the prime contractor, the prime contractor would be the consumer of materials as the construction contractor with the obligation to both furnish and install the materials, unless the prime contractor complies with Regulation 1521(b)(2)(A)2., so as to be a retailer with respect to those materials.

⁴ Title to tangible personal property generally would pass to the purchaser on the reservation only if (1) the seller delivered the tangible personal property by its own facilities (e.g., its own trucks) to the reservation; or (2) the seller shipped the tangible personal property (e.g., by mail or common carrier) F.O.B. destination on the reservation without including a provision passing title sooner. (Reg. 1628(b)(3)(D); Cal. U. Com. Code § 2401.)

As such, the contract language you quote is sufficient, pursuant to Regulation 1521(b)(2)(A)2., to qualify F--- as a retailer when it sells materials to the Tribe.⁵ F---'s retail sales of materials to the Tribe will be subject to tax unless the requirements of Regulation 1616(d)(4)(A) are fulfilled. Regulation 1616(d)(4)(A) requires (1) that the property be delivered to the Indian purchaser on the reservation and (2) that ownership (title) transfer to the Indian purchaser on the reservation. Accordingly, only a retail sale in which the construction contractor is the retailer of materials pursuant to 1521(b)(2)(A), and both delivers the material to the Tribe on the reservation and transfers (ownership) title to the Tribe on the reservation prior to use (installation) is exempt from tax.

In determining when title passes to the Tribe, the general rule is that title can pass no later than when the retailer completes its duties with respect to physical delivery of the property. (Cal. U. Com. Code § 2401; Reg. 1628(b)(3)(D).) When delivery is made by facilities of the retailer, this occurs when the retailer physically delivers the property to the purchaser. (Reg. 1628(b)(3)(D).) When delivery is made by mail or other independent common carrier, the retailer completes its performance with reference to the physical delivery of the property at the time and the place of shipment, e.g., when the retailer delivers the property to the carrier for shipment to the purchaser. (*Ibid.*) However, title to identified property can be passed to the purchaser (and the sale occur) prior to the time the seller completes physical delivery of the property to the purchaser if the contract of sale so provides. (Cal. U. Com. Code § 2401.)

In this case, in order to fulfill the requirements that title and possession of the materials actually pass to the Indians on the reservation, F---'s contract with the Tribe must also include a statement that all shipments (unless the shipments are delivered by F---'s own facilities, e.g., by F---'s own trucks) must be shipped F.O.B. the reservation, and cannot include a provision passing title prior to that time. (Reg. 1628(b)(3)(D).) In addition, the materials must in fact be so shipped, so the invoices and bills of lading must also designate that the materials be shipped F.O.B. the reservation. In other words, unless the contract language, invoices and bills of lading each state that the materials are to be shipped F.O.B. the reservation, even if the contract provides that title passes on the reservation, title would actually pass to the Tribe upon delivery of the materials to the carrier for shipment, and tax would apply to F---'s sale of the materials to the Tribe. The only exception to this would be instances in which the delivery is by F---'s own facilities.

Lastly, we note that regardless of whether F---'s retail sale of materials to the Tribe is subject to tax, a construction subcontractor that sells materials to F--- may accept a resale certificate (as provided in Regulation 1668) from F--- as the retailer of those materials, when F--- sells materials to the Indian Tribe in compliance with Regulation 1521(b)(2)(A)2. As we have discussed, when the subcontractor accepts a resale certificate from F--- for materials which F--- resells to the Tribe in an exempt sale under Regulation 1616(d)(4)(A), the subcontractor must also obtain (and F--- must make available) a copy of the exemption certificate provided by the Tribe to F---

“1. What happens if the amount provided in the contract for materials ends up being more or less than actual?”

⁵ As we discussed previously, we have assumed that the language in the subcontracts is not identical to the contract language you quote in your letter, but instead explicitly provides for transfer of title to the materials to F--- prior to the time the materials are installed, and separately states the sale price of the materials exclusive of the charge for installation.

We assume that the above question refers to a change order for additional work. As such, any change in an amount provided for in the contract is an amendment to the contract. Like the original contract between F--- and the Tribe, any amendment to that contract must conform to the contract requirements spelled out in Regulations 1521(b)(2)(A)2. and 1616(d); (1) it must separately state the sales price of materials, exclusive of the charge for installation (e.g., a time and material contract as described in Regulation 1521(a)(7)); (2) it must explicitly provide for the transfer of title to the Tribe on the reservation prior to the time the materials are installed; (3) it must include a statement that all shipments (unless the shipments are delivered by F---'s own facilities, e.g., by F---'s own trucks) must be shipped F.O.B. the reservation; and (4) in fact, these contractual provisions must be carried out.⁶

“2. Are F--- and F---'s subcontractors required to have seller's permits from the Board of Equalization?”

Under the transaction you have described, yes. Under the Sales and Use Tax Law, a seller means and includes every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sales of which are required to be included in the measure of sales tax. (Rev. and Tax. Code § 6014.) Any person engaged in the business of selling tangible personal property in California must apply for and obtain a seller's permit from the Board of Equalization. (Rev. and Tax. Code § 6066, Reg. 1699(a).) If the subcontractors sell materials to F--- as discussed above, they must register for seller's permits and file tax returns. If F--- in turn sells materials to the Tribe, it too must register for a permit and file tax returns.

We note that the holder of a seller's permit is required to remit tax imposed on its retail sales. (Rev. & Tax. Code §§ 6051, 6454; Reg. 1699.) The burden of proving that a sale of tangible personal property is not at retail is upon the seller, unless the seller takes a timely and valid resale certificate from its purchaser establishing that the property is purchased for resale. (Reg. 1668(a)(1).) We further note, as discussed above, that when a subcontractor as seller accepts a resale certificate from F--- for materials resold to the Tribe in an exempt sale, the subcontractor must also obtain from F--- a copy of the exemption certificate given to F--- by the Tribe.

Applications for seller's permits may be obtained by contacting the Board's Sacramento District office at 3321 Power Inn Road, Suite 210, Sacramento, telephone: (916) 227-6700. For your reference, we are also enclosing Board Publication 73, “Your California Seller's Permit.” The Board's other district offices and their telephone numbers are listed in this publication.

“3. How exactly does this work? For example, does F--- purchase the material without paying sales tax and using a resale number, and then, sell it to the tribe without sales tax? How is this reported to the Board of Equalization?”

⁶ As noted before, if a subcontractor in fact passes title, not to the Indian Tribe, but to the prime contractor, the prime contractor would be the consumer of materials as the construction contractor with the obligation to both furnish and install the materials, unless the prime contractor complies with Regulation 1521(b)(2)(A)2., so as to be a retailer with respect to those materials.

As discussed above, to qualify as a retailer, F--- must purchase materials from its vendors pursuant to a contract which complies with the provisions of Regulation 1521(b)(2)(A)2. A resale certificate which is taken timely and in good faith will relieve the vendor, here F---'s subcontractor, from liability for sales tax. (Reg. 1668(a)(1). As we have noted, when a resale certificate is taken by the subcontractor from F--- for materials F--- resells to the Tribe in an exempt sale, a copy of the exemption certificate issued by the Tribe to F---, to demonstrate that F---'s sale is in fact an exempt sale, must be obtained by the subcontractor from F---, and F--- must make such copy of the exemption certificate available to the subcontractor. The vendor reports these sales to the Board as sales for resale. (*Ibid.*) On its sales and use tax return, the vendor reports its total gross sales for the reporting period on line one, and deducts its sales for resale on line four.

Under circumstances where the requirements of 1616(d)(4)(A) have been met (in addition to the requirements of Regulation 1521(b)(2)(A)2.), the retailer selling materials to the Indian Tribe should obtain an exemption certificate as described in Regulation 1667 from the Indian Tribe to substantiate that its sale to the Tribe is exempt from California sales or use tax. As we have noted, when the subcontractor sells to the prime contractor, that in turn sells to the Tribe in an exempt sale, the subcontractor accepting a resale certificate from the prime contractor must also obtain a copy of the exemption certificate issued by the Tribe to the prime contractor. The retailer reports its total gross sales for the reporting period on line one of its sales and use tax return, and deducts its exempt sales to the Tribe on line 10(f) of the return, clearly explaining the basis for the deduction as required by the instructions on the return.

“4. Do partial payment invoices from F--- to the owner and from F---'s subcontractors to F--- require a breakdown of the portion being billed for labor and the portion being billed for materials?”

In order for F--- to qualify as a retailer of materials to the Tribe under Regulation 1521(b)(2)(A)2., the materials must actually be sold to the Tribe, and the sales price of materials to the Tribe must be separately stated. Accordingly, the partial payment invoices from F--- to the Tribe must separately state the sales price of materials. In addition, subcontractors' partial payment invoices to F--- must also separately state the sales price of materials, in order for the subcontractors to qualify as sellers under Regulation 1521(b)(2)(A)2.

We trust this information responds to your inquiry.

Sincerely,

Carla J. Caruso
Senior Tax Counsel

CJC/ds

Enclosures: Regulation 1521, 1616, 1705; Proposed Amendments to Regulation 1616;
Pamphlet 73 (previously provided)

cc: --- District Administrator (--)